Supreme Court, U.S.
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No. 80-505

IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

ROSALIE M. ARLINGHAUS, individually and as Executrix of the Will of Frank H. Arlinghaus, deceased,

Petitioner,

v.

J. RICHMOND RITENOUR and JOHN J. LIPSKY,

Respondents.

PETITIONER'S REPLY BRIEF IN SUPPORT OF HER PETITION FOR A WRIT OF CERTIORARI

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TABLE OF CONTENTS

	Page
Table of Authorities	iii
Reply to Respondents' Statement of the Case	1
Argument	5
Point I - The Circumstances Under which a Finding of Fact Adverse to an Appellee May Be Set Aside by an Appellate Court in the Absence of a Cross-Appeal Are Unsettled . . .	5
Point II - If the Integrity of the Judgement Against Pepper Was Not Unsettled by the Court of Appeals, the Court Was Compelled to Reverse the Judgment in Favor of Ritenour and Lipsky as a Matter of Law	8
Point III - There Is a Conflict Among the Circuits with Respect to the Preclusionary Effect of a Party's Failure to Comply with Rule 28 of the Federal Rules of Appellate Procedure	11

Page

Point IV - There Is a Conflict Among the Circuits with Respect to Whether the Existence and Status of Merger Discussions are Material Facts which Must Be Disclosed by Corporate Insiders to Stockholders from whom they Purchase Securities . 14

Conclusion 20

TABLE OF AUTHORITIES

Cases Cited

	Page
Abilene Sheet Metal, Inc. v. NLRB, 619 F. 2d 332 (5th Cir. 1980)	13
Alton Box Board Co. v. Goldman, Sachs & Co., 560 F.2d 916 (8th Cir. 1977) . .	16
Davis v. Passman, 442 U.S. 228 (1979)	9
Dawson v. Andrus, 612 F.2d 1280 (10th Cir. 1980) . .	8
Goldberg v. Meridor, 567 F.2d 209 (2d Cir. 1977), cert. denied, 434 U.S. 1069 (1978)	16
Harris v. Plastics Mfg. Co., 617 F.2d 438 (5th Cir. 1980)	13
Langnes v. Green, 282 U.S. 531 (1931)	5, 6, 7
Morley Constr. Co. v. Maryland Cas. Co., 300 U.S. 185 (1937)	6, 7, 8

Page

Sea Cove Marina, Inc. v. Uhlendorf, 18 A.D.2d 1021, 239 N.Y.S.2d 29 (2d Dep't 1963), aff'd, 15 N.Y.2d 714, 256 N.Y.S.2d 340 (1965) 10

SEC v. Capital Gains Research Bureau, Inc. 375 U.S. 180 (1963) 18

Steadman v. SEC, 603 F.2d 1126 (5th Cir. 1979), cert. denied, 100 S. Ct. 1849 (1980) 16

Tri-Tron Int'l v. Velto, 525 F.2d 432 (9th Cir. 1975) 2

TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438 (1976) 16

United States v. Pipefitters Local 562, 434 F.2d 1127 (8th Cir. 1971), modified, 407 U.S. 385 (1972) 11, 12, 13

Page

Woolf v. S.D. Cohn & Co., 546 F.2d 1252 (5th Cir.), cert. denied, 434 U.S. 831 (1977) 16

Wright v. Heizer Corp., 560 F.2d 236 (7th Cir. 1977), cert. denied, 434 U.S. 1066 (1978) 16

Statutes Cited

Securities Exchange Act of 1934, 15 U.S.C. §78a et seq 18

Rules Cited

SEC Rule 10b-5, 17 C.F.R. §240.10b-5 . . . . . 16, 18, 19

SEC Rule 14a-9, 17 C.F.R. §240.14a-9 16

Sup. Ct. R. 34.1(a) 14

Fed. R. App. P. 28 . . . . . 11, 13, 14

Page

Other Authorities Cited

9 Moore's Federal Practice ¶228.02[2.-2] 13

Stern, "When to Cross-Appeal or Cross-Petition--Certainty or Confusion," 87 Harv. L. Rev. 763 (1974) . . 7

REPLY TO RESPONDENTS' STATEMENT OF THE CASE

Respondents' brief in opposition to Mrs. Arlinghaus's petition is replete with ad hominem attacks upon Mrs. Arlinghaus and her counsel, including unjustified accusations of misrepresentations, distortions and fabrications. Such tactics have no place in this Court, and petitioner specifically eschews any intention of responding in kind. Nevertheless, the record needs to be clarified with respect to certain of respondents' contentions.

For example, respondents deny that the District Court made a finding of fact that they had learned through merger negotiations that Teleservice had a probable corporate value of between $2,000,000 and $3,000,000 (Respondents' Brf., p. 7), and they characterize the Court's probable value

finding as "a conclusory finding... limited to an unrelated co-defendant" (id., p. 3) and a "conclusion of law" (id. p. 9). Respondents' claims are in error.

The District Court found that "negotiations for the sale of MTS indicated a probable corporate value of two to three million dollars," and it characterized that finding as a "fact."* (App. 77). As the Court of Appeals noted, that finding necessarily implied that Ritenour and Lipsky were aware of the corporation's probable value, since they were the ones who conducted the negotiations. (App. 29). The Court of Appeals devoted 13 pages of its opinion (App. 35-47) to a discussion of the

* Although the finding is reported in the "Conclusions of Law" section of the District Court's opinion, the placement of the finding is, of course, irrelevant to its nature or effect. Tri-Tron International v. Velto, 525 F.2d 432, 435 (9th Cir. 1975).

evidence supporting, and of its power to set aside, that finding of fact. If the Court had not set aside the finding of fact, it would have been required to reverse the judgments entered in favor of Ritenour and Lipsky.

Respondents also state that they "did not join with Pepper but refused to do so." (Respondents' Brf., p. 4; see also id., p. 30). Although the District Court ruled that they were initially "cool to the idea of Pepper buying into 'their' company" (App. 67), they ultimately decided to join forces with Pepper. Pepper drafted the "Ritenour-Lipsky-Pepper offer" (App. 20, 36, 37, 42), and it was Pepper who negotiated on behalf of the group with Mrs. Arlinghaus.

Respondents also confuse the record with respect to their efforts to find a merger partner for Teleservice.

Those efforts were initially authorized by the Teleservice board of directors in 1966 "in the expectation that Teleservice alone might not be able to meet its growing capital needs." (App. 10).* After several preliminary discussions, respondents reported their inability to find a company willing to acquire Teleservice for an acceptable price, and the board authorized the abandonment of their efforts to do.

Ritenour and Lipsky resumed discussions in the spring of 1967, and they conducted a number of concurrent negotiations during that period with potential merger partners, business brokers and investment bankers. Ritenour and Lipsky admitted that they had not

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* Respondents' suggestion that Mrs. Arlinghaus "instituted the efforts to sell the Company to pay estate taxes" (Respondents' Brf., p. 5) is utterly unsupported by the record and is contrary to the findings below.

disclosed to Mrs. Arlinghaus the identities of those companies and individuals or the status of the negotiations, and there is nothing in the record to suggest that Mrs. Arlinghaus had any independent knowledge of those facts.

ARGUMENT

POINT I

THE CIRCUMSTANCES UNDER WHICH A FINDING OF FACT ADVERSE TO AN APPELLEE MAY BE SET ASIDE BY AN APPELLATE COURT IN THE ABSENCE OF A CROSS-APPEAL ARE UNSETTLED

In her petition, Mrs. Arlinghaus argued that the Court of Appeals had erred in its holding that a lower court's findings of fact were subsumed within the so-called Langnes rule, which applies to a lower court's legal analysis and its conclusions of law. Respondents allege that "[n]ot one case found even whispers of such a differentiation." (Respondents Brf., p. 18).

The distinction was specifically identified in Morley Construction Co. v. Maryland Casualty Co., 300 U.S. 185, 191 (1937), a case decided subsequent to Langnes v. Green, 282 U.S. 531 (1931). In Morley, the Court set out the Langnes rule, which it characterized as "inveterate and certain," 300 U.S. at 191, and then considered whether that rule should also be applied to findings of fact. It explicitly decided to leave open the question whether findings of fact could be set aside if that would result in the affirmance of the lower court's judgment. Ibid.

Decisions subsequent to Morley have, until the Court of Appeals decision herein, uniformly rejected attacks by an appellee on adverse findings of fact -- without regard to whether setting aside the finding would cause the affirmance, modification or reversal

of the judgment below.

The law review article cited by the Court of Appeals and by respondents argues that the reported decisions can be harmonized by carving out various "exceptions to the Langnes rule" to rationalize what the author of the article referred to as "unexplained deviations from it." Stern, "When to Cross-Appeal or Cross-Petition -- Certainty or Confusion," 87 Harv.L.Rev. 763, 764 (1974).* The ineluctable fact is that there is no reported decision that resolves the issue left open in Morley. The issue is faced on a recurring basis by appellate courts and should

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* Respondents state that there are three exceptions (Respondents' Brf., p. 13 n.*). Mr. Stern suggests that there may be a fourth, and he urges the Court to "explain both the scope of the exception and its rationale." 87 Harv.L.Rev. at 773.

be resolved by this Court.*

POINT II

IF THE INTEGRITY OF THE JUDGMENT AGAINST PEPPER WAS NOT UNSETTLED BY THE COURT OF APPEALS, THE COURT WAS COMPELLED TO REVERSE THE JUDGMENT IN FAVOR OF RITENOUR AND LIPSKY AS A MATTER OF LAW

Respondents argue that the integrity of the judgment against Pepper was not unsettled by the Court of Appeals, because the alternative basis for the District Court's judgment against Pepper (his affirmative misrepresentations) remains valid. That Mrs. Arlinghaus did not act in reliance on those misrepresentations, is, they

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* The confusion as to the resolution of this issue is not, as suggested by respondents, "in Petitioner's mind alone." (Respondent's Brf., p. 19). In a recent opinion, the Court of Appeals for the Tenth Circuit, citing Morley, expressed its "doubt" as to whether a finding of fact could be set aside in the absence of a cross-appeal, even though overturning the finding would have enabled the Court to affirm the district court's judgment. Dawson v. Andrus, 612 F.2d 1280, 1282 (10th Cir. 1980).

argue, irrelevant, since under New York law damages are not necessary for a cause of action for breach of fiduciary obligations.

However, "the question whether a litigant has a 'cause of action' is analytically distinct and prior to the question of what relief, if any, a litigant may be entitled to receive." Davis v. Passman, 442 U.S. 228, 239 (1979).

The District Court did not merely rule that Mrs. Arlinghaus had met the pleading requirements for a cause of action against Pepper. It adjudged Pepper liable for compensatory damages of $176,837.40. (App. 111). If Mrs. Arlinghaus had not been induced to sell her stock at an artifically low price by Pepper's breaches of his fiduciary obligations (i.e., if she had not acted in reliance thereon), he would not have

been liable to her for compensatory damages. Thus, the finding of fact set aside by the Court of Appeals is essential to the integrity of the judgment against Pepper.

Respondents also argue that the judgment against Pepper, if valid, does not compel the entry of judgment against them because they did not "knowingly join" in Pepper's breach of his fiduciary relationship. Under the decisions of this Court cited in the petition, the sole requirements for holding a non-fiduciary jointly liable with a fiduciary are (i) knowledge by the non-fiduciary of the fiduciary's breach and (ii) some benefit to the non-fiduciary as a result of the breach. Both of those requirements have been satisfied in this case. See Petition, pp. 32-33, and cases cited therein. See also Sea Cove Marina, Inc. v. Uhlendorf, 18

A.D.2d 1021, 239 N.Y.S.2d 29, 31 (2d Dep't 1963), aff'd, 15 N.Y.2d 714, 256 N.Y.S.2d 340 (1965).

POINT III

THERE IS A CONFLICT AMONG THE CIRCUITS WITH RESPECT TO THE PRECLUSIONARY EFFECT OF A PARTY'S FAILURE TO COMPLY WITH RULE 28 OF THE FEDERAL RULES OF APPELLATE PROCEDURE

Respondents assert that there is no conflict among the courts of appeals as to whether a court of appeals may properly review issues not raised or argued by the litigants in their opening briefs. They argue that insistence on adherence to that rule is discretionary with the appellate court.

That very issue divided the Court of Appeals for the Eighth Circuit in United States v. Pipefitters Local 562, 434 F.2d 1127 (8th Cir. 1970) (en banc), modified on other grounds, 407 U.S. 385 (1972). The dissent in that case argued

in favor of the result reached by the Court of Appeals herein, especially since the issue in question had been fully briefed and argued in the proceedings before the en banc Court. Many of the arguments mustered by the dissent in that case were echoed by the Court of Appeals herein and by respondents in their brief. Those arguments were rejected by the majority of the Court, who criticized the kind of approach taken by the Court of Appeals in this case:

> "Certainly, the reviewing court should not assume the role of an advocate and engage in the practice of ferreting out errors.... Such gratuitous procedure by the reviewing court does not, in my view, comport with the proper and orderly administration of justice.
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> * * *
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> "Thus, the conclusion is inescapable that the Supreme Court has decreed through adoption of the rules that all appeals in the courts of appeals are to be governed by the provisions of the

> Federal Rules of Appellate Procedure. These rules are easily understood. They mean what they say. They are binding upon every judge of every court of appeals and should be adhered to, not ignored. If courts of appeals are permitted to engage in fashioning remedies according to the dictates of the judges and contrary to the guidelines enunciated in the rules, one of the objectives so long sought and finally achieved - uniformity of practice and procedure - will effectively be scrapped." Id. at 1129-30 (emphasis in original).

See also Abilene Sheet Metal, Inc. v. NLRB, 619 F.2d 332, 348 n.9 (5th Cir. 1980); Harris v. Plastics Manufacturing Co., 617 F.2d 438, 440 (5th Cir. 1980); 9 Moore's Federal Practice ¶228.02[2.-2] n.2.

In short, there are clear and irreconcilable differences among the courts of appeals concerning the preclusionary effects of a failure to raise and argue an issue in accordance with Rule 28. The Court of Appeals in this case has ruled that it has the

discretion to consider such an issue under certain circumstances; other courts of appeals have ruled that the prohibition is mandatory; still others have ruled that the decision is discretionary but have set down standards governing the exercise of that discretion that are different from those enunicated by the Court of Appeals in this case.*

POINT IV

THERE IS A CONFLICT AMONG THE CIRCUITS WITH RESPECT TO WHETHER THE EXISTENCE AND STATUS OF MERGER DISCUSSIONS ARE MATERIAL FACTS WHICH MUST BE DISCLOSED BY CORPORATE INSIDERS TO STOCKHOLDERS FROM WHOM THEY PURCHASE SECURITIES

Respondents argue that the Court of Appeals found that they did not know

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* Supreme Court Rule 34.1(a), unlike F.R.A.P. 28, expressly allows the Court to "consider a plain error not among the questions presented but evident from the record and otherwise within its jurisdiction to decide."

that Teleservice had a probable corporate value in excess of what they paid to Mrs. Arlinghaus; that, therefore, the "value was not a material fact known to them which they should therefor [sic] have disclosed to Pettioner"; that no court of appeals has ever required a corporate insider to disclose facts that were not material; and that, as a result, there is no conflict among the circuits. (Respondents' Brf., p. 37). Respondents have misconstrued Mrs. Arlinghaus's argument.

Mrs. Arlinghaus contends that the Court of Appeals should have reversed the judgment in favor of Ritenour and Lipsky because of their failure to disclose the existence and status of ongoing merger discussions, facts which every other court of appeals that has considered the issue has held to be

material. She is not attempting to have this Court redefine "materiality". The definition is clear: a fact is material if there is "a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder." TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976).*

It is inconceivable that a reasonable stockholder would not think that

* Although the issue in that case concerned the materiality standard under SEC Rule 14a-9, the courts that have addressed the issue have uniformly concluded that the TSC standard also applies to actions under Rule 10b-5. See, e.g., Woolf v. S.D. Cohn & Co., 546 F.2d 1252 (5th Cir.) (per curiam), cert. denied, 434 U.S. 831 (1977); Steadman v. SEC, 603 F.2d 1126, 1130 (5th Cir. 1979), cert. denied, 100 S.Ct. 1849 (1980); Goldberg v. Meridor, 567 F.2d 209, 218-19 (2d Cir. 1977), cert. denied, 434 U.S. 1069 (1978); Alton Box Board Co. v. Goldman, Sachs & Co., 560 F.2d 916, 919-20 (8th Cir. 1977); Wright v. Heizer Corp., 560 F.2d 236, 248 (7th Cir. 1977), cert. denied, 434 U.S. 1066 (1978).

the merger information concealed in this case was important, and, therefore, material, to his or her consideration of whether to sell securities on the terms offered by Ritenour, Lipsky and Pepper. In their brief, respondents discuss the court of appeals decisions Mrs. Arlinghaus cited in her petition and attempt to identify some factual distinction between each of those cases and the case at bar. Each of the alleged distinctions is immaterial.* Until the Court of Appeals decision herein, no reported decision had ever held that a corporate insider was free

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* In some instances, respondents try to distinguish the cases on the grounds that the defendants in those cases admitted their failure to disclose merger discussions (Respondents' Brf., pp. 43, 48). That purported distinction -- the significance of which is unclear in any event -- is of no assistance to respondents, since they admitted that they had disclosed literally nothing to Mrs. Arlinghaus in connection with their purchase of stock from her.

to purchase stock during ongoing merger discussions without fully disclosing all of the facts surrounding those discussions.

Given the experience of the federal courts with this issue, Mrs. Arlinghaus respectfully renews her suggestion that the Court grant her petition for the purpose of considering whether it should declare that a corporate insider's knowledge concerning ongoing merger negotiations is a fact that is material per se for purposes of the "disclose or abstain" rule under Rule 10b-5. Such a declaration would have the salutary effect of expediting otherwise expensive and protracted litigation and would foster the "fundamental purpose" of the Securities Exchange Act of 1934 and its companion acts "to substitute a philosophy of full disclosure for the philosophy of caveat emptor." SEC v.

Capital Gains Research Bureau, Inc., 375 U.S. 180, 186 (1963).*

Whether it is appropriate to enunciate a per se rule to govern this type of 10b-5 action is, however, not determinative of the question whether the instant decision of the Court of Appeals conflicts with that of other courts of appeals. As pointed out in the petition, the discussions Ritenour and Lipsky had with potential merger partners, business brokers and investment bankers were as extensive as those held to be material by four other courts of appeals. This Court should grant Mrs. Arlinghaus's petition to resolve that conflict.

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* Such a rule would not mean that "the vaguest explorations would require reporting to the stockholders." (Respondents' Brf., p. 39). Corporate insiders would still be free to maintain the confidentiality of merger negotiations so long as they did not purchase stock from shareholders ignorant of those discussions.

CONCLUSION

For all of the foregoing reasons, a writ of certiorari should issue to review the judgment and opinion of the Second Circuit.

Respectfully submitted,

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